

Audit

Report



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MAJOR DEFICIENCIES IN THE COMPIRATION AND
CONSOLIDATION OF THE FINANCIAL STATEMENTS
FOR OTHER DEFENSE ORGANIZATIONS

Report Number 99-062

December 29, 1998

Office of the Inspector General
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Acronyms

CFO	Chief Financial Officer
DFAS	Defense Finance Accounting Service
IG	Inspector General



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

December 29, 1998

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Major Deficiencies in the Compilation and Consolidation of
the Financial Statements for Other Defense Organizations
(Report No. 99-062)

We are providing this report for your information and use. It identifies and summarizes the major deficiencies that contribute to the Other Defense Organizations financial statements being unreliable. It also identifies and summarizes actions taken or under way to correct those deficiencies. Because this report contains no recommendations, no written comments were required, and none were received.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson at (703) 604-9582 (DSN 664-9582) (crichton@dodig.osd.mil) or Mr. Leon Peek at (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma
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Office of the Inspector General, DoD

Report No. 99-062
(Project No. 8FA-2010.02)

December 29, 1998

Major Deficiencies in the Compilation and Consolidation of the Financial Statements for Other Defense Organizations

Executive Summary

Introduction. We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The DoD Consolidating Financial Statements for FY 1997 include financial statements for a reporting entity entitled "Other Defense Organizations." This entity represents a consolidation of financial information from various Defense organizations and funds including the Military Departments that use the Treasury Index 97 (Department 97) symbol. During FY 1997, the 44 Defense organizations and funds included in Other Defense Organizations received \$39.1 billion in direct appropriations, or about 15 percent of the DoD budget. The FY 1997 consolidated financial statements for Other Defense Organizations disclosed total assets of \$46.5 billion and liabilities of \$222.2 billion.

Objectives. The audit objectives were to identify and summarize the major deficiencies that caused the Other Defense Organizations financial statements to be unreliable, and to identify the actions taken or underway to correct those deficiencies

Results. We continue to identify and report deficiencies that demonstrate that the financial statements of Other Defense Organizations do not accurately represent the financial position and the results of operations for the Other Defense Organizations. For example, the \$218 billion Military Retirement Health Benefits Liability estimate included in the FY 1997 financial statements was based on incomplete and unreliable health care information. DoD Components and the Defense Finance and Accounting Service have acknowledged problems that caused DoD financial statements to be unreliable and have taken corrective actions to correct many problems identified in prior audit reports. At least one major deficiency—a lack of integrated, double-entry transaction-driven general ledgers—is expected to take several years to correct. However, other deficiencies—such as untimely reporting of required information, inadequate support for adjustments, lack of reconciliations, and inability to disclose all required information—can be corrected prior to establishing compliant accounting systems. Until additional improvements in accounting systems and internal controls are made, the consolidated financial statements for Other Defense Organizations will not be reliable.

Management Comments. Because this report contains no findings or recommendations, written comments were not required, and none were received

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Background

Requirements for Financial Statements. Public Law 101-576, the "Chief Financial Officers (CFO) Act of 1990," November 15, 1990, requires Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. In a June 6, 1995, memorandum, the DoD Deputy Chief Financial Officer notified the DoD Components of the requirement to submit financial statements in accordance with the Federal Financial Management Act of 1994. DoD Regulation 7000.14-R, "Financial Management Regulation," states that DoD Components are responsible for the accuracy, completeness, and documentary support for all data submitted to the Defense Finance and Accounting Service (DFAS) for inclusion in financial reports

Other Defense Organizations. The DoD consolidating financial statements include financial information for a reporting entity entitled, "Other Defense Organizations." This entity represents a consolidation of financial information for the various Defense agencies, funds, and accounts using Treasury Index No. 97 (Department 97), and financial information for the portion of the Department 97 funds suballocated to the Military Departments. Other Defense Organizations received \$39.1 billion in direct funding during FY 1997, or about 15.5 percent of the total DoD Budget. The consolidated FY 1997 financial statements for Other Defense Organizations showed total assets of \$46.5 billion and liabilities of \$222.5 billion. Of the \$222.5 billion of liabilities, \$218 billion was an unfunded liability estimate for Military Retirement Health Benefits

DFAS Roles and Responsibilities. During FYs 1995, 1996, and 1997, DFAS and other accounting offices provided support for most Defense organizations using Department 97 funds. The roles and responsibilities of DFAS and its customers regarding proper and consistent preparation of the financial reports are defined in DoD Regulation 7000.14-R, volume 6, "Reporting and Policy Procedures," February 1996. Volume 6 requires DFAS to establish procedures to ensure that the process for preparing financial reports is consistent, timely, and auditable, and that controls are in place to provide for the accuracy of the reports. Beginning in FY 1996, the DFAS Indianapolis Center became responsible for preparing the consolidated financial statements for Department 97 funds.

Objectives

The overall objective was to identify and summarize the major deficiencies contributing to the lack of reliability of the Other Defense Organizations financial statements. Specifically, we reviewed the major deficiencies identified in audits of the FYs 1996 and 1997 financial statements for Other Defense Organizations,

reviewed the recommendations to correct those deficiencies, and reviewed the status of actions taken or under way to correct those deficiencies. A summary of the seven prior audit reports included in the audit objective is in Appendix B.

Major Deficiencies in the Compilation and Consolidation of the Financial Statements for Other Defense Organizations

We continue to identify and report deficiencies that demonstrate that the financial statements of Other Defense Organizations do not accurately represent the financial position and the results of operations for the Other Defense Organizations. The accuracy and reliability of the consolidated financial statements were diminished primarily because:

- the accounting offices that support the Defense organizations did not have complete, transaction-driven general ledger accounting control systems to accumulate and report financial information, and did not fully comply with the monthly and year-end financial statement reporting requirements; and
- DFAS Indianapolis Center had not established effective internal controls to support \$200 billion in adjustments in FYs 1996 and 1997, to perform reconciliations, to include all required accounting balances, and to disclose all required information in the Notes to the financial statements.

DoD and DFAS have corrected many problems identified in prior audit reports. For example, DFAS corrected computer-programming errors identified during the audit of the FY 1996 compilation process. Also, DFAS included accounts payable and accounts receivable for closed appropriation accounts that were reopened by the Department of the Treasury in the FY 1997 Statement of Financial Position. However, actions taken to correct deficiencies identified in this report were not fully completed, or in some cases may not be corrected for years. In addition, the Other Defense Organizations Statement of Financial Position (Balance Sheet in FY 1998) includes a \$218 billion estimated Military Retirement Health Benefits unfunded liability that was based on incomplete and unreliable health care information. Until improvements in the accounting systems and internal controls are made, the results of operations and financial position reported in the consolidated financial statements for Other Defense Organizations will not be reliable. This finding summarizes those deficiencies and discusses actions taken or underway to correct them.

Accounting Systems

Key Accounting Requirement¹ No. 1 requires that an accounting system have general ledger control and maintain a DoD-approved general ledger account structure for assets, liabilities, equity, expenses, losses, gains, transfers in and out, and other financial resources. The general ledger, and its subsidiary ledgers, should serve as the source data base for producing required financial statements. However, financial audits performed at the DFAS Indianapolis Center during FYs 1995, 1996, and 1997 showed that DoD financial accounting systems were not fully compliant with regulatory and statutory requirements. Specifically, DoD organizations or their supporting accounting offices did not have integrated, double-entry transaction-driven general ledgers to compile and report reliable and auditable financial information.

DoD and DFAS have recognized the long-standing problems in the lack of compliant accounting systems and have taken actions to fix noncompliant accounting systems. In April 1996, DFAS established the Defense Accounting Systems Project Management Office (now the Systems Integration Directorate) to provide central management oversight for systems substantially owned by DFAS. (Most of the accounting systems used by Other Defense Organizations are substantially owned and operated by the DFAS.) However, DoD and DFAS proposed solutions to fix noncompliant accounting systems may not be completed for many years because proposed initiatives need to be tested and implemented to measure their success. DoD and DFAS reported in the FY 1997 Annual Statement(s) of Assurance that deficiencies in accounting systems used by the Military Departments and Other Defense Organizations may not be corrected until FY 2002, at the earliest.

Trial Balance Submissions

The accounting offices that support Other Defense Organizations did not fully comply with monthly or year-end reporting requirements established by the DFAS Indianapolis Center. As a result, the DFAS Indianapolis Center could not keep the Departmental general ledger current; and could not provide needed financial information in a timely manner.

Monthly Trial Balance Submissions. Due to the lack of complete general ledger accounting control systems, the DFAS Indianapolis Center instituted an interim process for accumulating and consolidating Other Defense Organizations' financial data in March 1996 while waiting for a permanent solution. That process included a requirement for accounting offices to submit monthly trial balances to the DFAS Indianapolis Center for a review for errors or omissions and to update Departmental records throughout the year. That process would have eliminated the majority of the year-end adjustments to trial balances for Other

¹DoD Regulation 7000.14-R, volume 1, shows 13 Key Accounting Requirements. Key Accounting Requirements are a composite of regulations issued by the General Accounting Office, Office of Management and Budget, the Department of Treasury, and DoD. All DoD accounting systems must comply with Key Accounting Requirements.

Defense Organizations and expedited preparation of the consolidated principal statements. However, audits at the DFAS Indianapolis Center during FYs 1996 and 1997 show that the accounting offices supporting Other Defense Organizations did not fully comply with the monthly reporting requirements. Inspector General (IG), DoD, Report No. 99-006, "Consolidation Process for FY 1997 Financial Statements for Other Defense Organizations," October 6, 1998, recommended that accounting offices report trial balances quarterly. Quarterly reporting should make it easier for accounting offices to prepare required trial balances. If DFAS Indianapolis Center begins its planned reviews of the trial balances early, many year-end adjustments should be eliminated.

Year-end Trial Balance Submissions. To meet the CFO reporting requirements, the DFAS Indianapolis Center established milestones for reporting information. In a June 25, 1995, memorandum to the Defense agencies and supporting accounting offices, the DFAS Indianapolis Center requested that all year-end trial balances for the Defense organizations be submitted to the DFAS Indianapolis Center by November 1 for FY 1996 and each succeeding fiscal year. However, audits during FYs 1996 and 1997 determined that the supporting accounting offices did not submit required financial information to the DFAS Indianapolis Center by the deadline. For example, the National Security Agency and the Defense Special Weapon Agency did not submit their FY 1997 year-end trial balances until November 24, 1997. Even if supporting accounting offices met the November 1 deadline, the DFAS Indianapolis Center would not have had time to review, adjust, and compile the initial trial balances, which are required to be given to the IG, DoD, during October each year.²

Untimely submissions by supporting accounting offices contributed to DFAS Indianapolis Center's problem in reviewing and preparing consolidated financial information for Other Defense Organizations. To ensure that the DFAS Indianapolis Center had sufficient time to adequately review and compile the financial information received from the supporting accounting offices, the audit on the consolidation process audit (IG, DoD, Report No. 99-006) recommended that the DFAS Indianapolis Center require supporting accounting offices to submit trial balances sooner.

DFAS Compilation Process

Prior IG, DoD, audits reported that DFAS Indianapolis Center needed improvements in documenting audit trails for adjustments, in performing required reconciliations, and in reviewing financial information submitted by the supporting accounting offices.

Year-end Adjustments to the Trial Balances. The DFAS Indianapolis Center adjusted the year-end trial balances for Other Defense Organizations to agree with the certified Report(s) on Budget Execution without reconciling or explaining the differences. DoD Regulation 7000.14-R, volume 6, requires DFAS to adequately

²A June 6, 1997, Memorandum of Understanding between the DoD Deputy Chief Financial Officer, DFAS, and the IG, DoD, agreed that DFAS would provide "preliminary year-end account balances and trial balances to auditors" in October each year. On December 11, DFAS would provide a working copy of the financial statements with Notes to the auditors.

support and justify in writing any adjustments to the official accounting records, and to obtain customer approval before recording adjustments. However, audits of the compilation process for Other Defense Organizations showed that the DFAS Indianapolis Center made 47 year-end adjustments totaling \$88.3 billion for FY 1996, and 56 year-end adjustments totaling \$111.5 billion for FY 1997 without a complete audit trail to supporting documentation.

Using Report(s) on Budget Execution as a primary source for producing financial statements is an acceptable substitute only until a reliable general ledger is fully deployed. However, while waiting for compliant accounting systems, the DFAS Indianapolis Center and the supporting accounting offices must research and document the variances between the two financial records.

Reconciliations of Fund Balance With Treasury. Statement of Federal Financial Accounting Standards No. 1, "Accounting for Selected Assets and Liabilities," March 30, 1993, requires DFAS to explain any discrepancies between Fund Balance With Treasury in the DFAS general ledger accounts and the balance in the Department of the Treasury' accounts and explain the causes of the differences in the footnotes to the financial statements. DFAS Indianapolis Center used the Department of Treasury's records instead of the Defense agencies' records as the primary source for reporting Fund Balance With Treasury amounts for Other Defense Organizations for FYs 1996 and 1997 financial statements. Also, the DFAS Indianapolis Center did not reconcile or explain the differences of \$19 billion for FY 1996, and \$5.3 billion for FY 1997 when preparing the financial statements for Other Defense Organizations

To correct this deficiency, DoD plans to discontinue reporting cash balances shown in Treasury records and report the Fund Balance with Treasury shown in DoD accounting records with full disclosure of the differences. Also, in an effort to reconcile the differences between Treasury and DoD accounting records, DFAS announced the implementation of standard Departmental Reporting and Cash Accountability Systems responsible for cash accountability and reconciliation for all appropriations. Part of the planned internal control structure is an automated reconciliation between the Financial Statement line, Fund Balance With Treasury, and Treasury Cash Accountability Reports. The internal controls are to be in place by December 1998. Although the DFAS has planned corrective actions to correct the reconciliation deficiencies, the initiatives need to be tested and implemented to measure their success

Compilation of Statements. The DFAS Indianapolis Center is attempting to compile Other Defense Organizations financial statements without the benefit of monthly or quarterly statements. Also, the Center tasks the same personnel who compile the Army Consolidated General Funds Financial Statements to prepare the financial statements for Other Defense Organizations. However, the financial statements for Other Defense Organizations are secondary to the financial statements for the Army. Because of the lack of adequate resources and stringent CFO milestones established to compile the financial statements for Other Defense Organizations, the DFAS Indianapolis Center was unable to thoroughly review financial information submitted by the supporting accounting offices.

During the FYs 1996 and 1997 compilation process for Other Defense Organizations, the DFAS Indianapolis Center made \$200 billion in adjustments to correct discrepancies found without coordinating with the supporting accounting offices to obtain detailed supporting documentation. For example, prior audits showed that supporting accounting offices continued posting transactions to obsolete accounts. Instead of coordinating with the offices to determine the appropriateness or accuracy of the transactions, the DFAS Indianapolis Center assumed that the accounting offices mistakenly posted transactions to the wrong accounts. Accordingly, the DFAS Indianapolis Center unilaterally made \$47 billion of adjustments to Other Defense Organizations' equity accounts for FYs 1996 and 1997.

To ensure that the DFAS Indianapolis Center has sufficient resources to adequately compile the financial statements for the Other Defense Organizations, we recommended in IG, DoD, Report No. 98-027, "Comprehensiveness of the FY 1996 Other Defense Organizations Financial Statements," November 28, 1997, that the DFAS Indianapolis Center review the staffing requirements to support the consolidation and compilation process. DFAS Indianapolis Center performed a staffing review and determined that the CFO office (Departmental Accounting Support Team 2) needed 15 positions to adequately perform the required tasks. We will continue to follow-up on this issue to determine whether the DFAS Indianapolis Center has the required resources and if further improvements in the reviewing process are needed.

Presentation and Disclosure of Financial Information

Audits performed at the DFAS Indianapolis Center during FYs 1996 and 1997 showed that the DFAS Indianapolis Center did not always comply with Federal and DoD guidance when preparing and presenting the Other Defense Organizations financial statements. Specifically, balances from canceled appropriations were incorrectly excluded and improvements were needed in preparation of the Notes.

Reporting all Appropriations in the Financial Statements. In FY 1997, the DFAS Indianapolis Center included all appropriations reopened by the Department of the Treasury in the Other Defense Organizations financial statements as we recommended during the audit of the FY 1996 financial statements. However, due to an oversight, the DFAS Indianapolis Center continued to exclude certain assets and liabilities for canceled appropriations during the preparation of the FY 1997 financial statements. The DFAS Indianapolis Center erroneously excluded \$483 million in negative accounts payable and \$68 million in accounts receivable. IG, DoD, Report No. 99-014, "Compilation of the FY 1997 Financial Statements for Other Defense Organizations," October 15, 1998, recommended actions to include those assets in the FY 1998 financial statements. We will continue to follow-up on this issue to determine if the DFAS Indianapolis has corrected this deficiency.

Notes to the Financial Statements. The DFAS Indianapolis Center initiated corrective action for many of the reported problems related to the FY 1996 Notes to the financial statements, and the FY 1997 Notes to the financial statements for Other Defense Organizations provided much better disclosure. However, the

FY 1997 Notes to the financial statements showed continued deficiencies in the Notes and instances where previously reported deficiencies were not corrected. For example, the DFAS Indianapolis Center did not explain the causes for large variances in the financial statement line items from year to year. Accordingly, additional controls and procedures were necessary to ensure that all applicable Notes were prepared and all information required by DoD Form and Content Guidance were precisely presented in the Notes to the financial statements. Implementation of recommendations in the IG, DoD, Report No. 99-014, will further improve disclosure of required information in Notes to the financial statements in future years.

Military Retirement Health Benefits. Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, provides that DoD calculate and report the liabilities for "other retirement benefits." FY 1997 was the first year that the unfunded liability for military retirees' medical health benefits was reported on the DoD-wide financial statements. The Office of the DoD Actuary was tasked with developing the estimated liability. IG, DoD, Report No. 99-010, "DoD Military Retirement Health Benefits Liability for FY 1997," October 13, 1998, reported that the estimated liability was based on information from the Composite Health Care System. The information provided to the Office of the DoD Actuary was incomplete and unreliable. Therefore, the estimated liability of \$218 billion was unreliable.

Conclusion

The conditions cited in this report are not expected to be corrected during the preparation of the FY 1998 financial statements. However, the DFAS has acknowledged problems that caused DoD financial statements to be unreliable and has implemented many initiatives directed at improving the DoD financial accounting systems and related internal controls.

Appendix A. Audit Process

Scope and Methodology

We reviewed the results of the seven compilation and consolidation audits of the FYs 1996 and 1997 consolidating financial statements for Other Defense Organizations. See Appendix B for a list of the audit reports reviewed. We used those IG, DoD, audits to identify major deficiencies contributing to the lack of reliability of the financial statements for Other Defense Organizations. We further used management comments to the audit reports and discussions with DFAS Indianapolis Center personnel to identify actions taken or under way. This audit was limited to identifying and summarizing the major deficiencies that contributed to the lack of reliability of the Other Defense Organizations financial statements and actions taken or underway to remove those deficiencies.

DoD-wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Department of Defense has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal.

Objective: Fundamentally reengineer the Department and achieve a 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management objective: Strengthen internal controls **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High Risk Area. The General Accounting Office has identified several high risk areas in the DoD. This report provides coverage of the Defense Financial Management high risk area.

Audit Type, Dates, and Standards. We performed this financial-related audit during the period June 1998 through September 1998. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD, subject to the limitations described in this Appendix. We did not use computer processed data or statistical sampling procedures to conduct this audit.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available upon request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provide reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. Our review of management controls was reported in other reports listed in Appendix B. DoD and DFAS management has generally reported those weaknesses in their Annual Statement(s) of Assurance.

Appendix B. Summary of Prior Coverage

The IG, DoD, has issued seven reports on the compilation and consolidation of financial statements for Other Defense Organizations for FYs 1996 and 1997.

Report No. 99-014, "Compilation of the FY 1997 Financial Statements for Other Defense Organizations," October 15, 1998. The report states that the process used by DFAS Indianapolis Center to adjust, compile, and report financial information for Other Defense Organizations needed improvements to ensure financial statements were complete, consistent, accurate and fully supported. Specifically the DFAS Indianapolis Center:

- did not include \$68 million in accounts receivable from closed appropriations and a negative \$483 million in accounts payable,
- reduced Fund Balance With Treasury for Entity Assets by \$5.3 billion without performing required reconciliations, and omitted a negative \$1 billion from Fund Balance With Treasury for Non-Entity assets as shown on the "Report(s) on Budget Execution," and
- did not prepare comprehensive Notes to the FY 1997 Financial Statements in compliance with guidance from DoD and the Office of Management and Budget.

Unless the compilation process is improved, the financial statements of Other Defense Organizations will not be complete or reliable and will not meet the requirements of the Chief Financial Officers Act. The report recommended that the DFAS Indianapolis Center establish procedures for coordinating adjustments, correctly report closed appropriations, maintain complete audit trails for year-end adjustments, advise supporting accounting offices to stop using obsolete general ledger account codes, and establish procedures to ensure that discrepancies with Fund Balance With Treasury are researched and the causes documented. The report also recommended that the DFAS Indianapolis Center comply with current guidance when preparing the Notes to the financial statements. DFAS had not responded to the report.

Report No. 99-010, "DoD Military Retirement Health Benefits Liability for FY 1997," October 13, 1998. The report states that DoD reported a \$218 billion unfunded liability for military retirement health benefits liability, a material item on the Government financial statements, as well as on the DoD-wide consolidated financial statements for FY 1997. The Office of the Actuary, DoD, did not provide current and complete information to the contractor responsible for calculating the \$218 billion military retirement health benefits liability. Also, the Office of the Actuary, DoD, did not adjust the liability calculations for TRICARE, a new DoD healthcare program. Additionally, Note 19, "Pensions and Other Actuarial Liabilities," for the DoD consolidated FY 1997 financial statements did not adequately reflect the data assumptions that the contractor used to calculate the liability. As a result, the actuarial estimate for FY 1997 was unreliable, and unless changes are made, the estimate for FY 1998 and beyond will also be unreliable.

The report recommended that the Under Secretary of Defense (Comptroller) provide written instructions to the Office of the Actuary, DoD, on an annual basis regarding the information needed to satisfy the Office of Management and Budget and DoD financial statement requirements. The report also recommended that the Under Secretary of Defense for Personnel and Readiness direct the development of a documented integrated process for computing the unfunded military retirement health benefits liability. The Under Secretary of Defense (Comptroller) generally concurred with the recommendations and proposed responsive corrective actions. The Under Secretary of Defense for Personnel and Readiness comments included an integrated process in the action plan for achieving an unqualified opinion for FY 1999.

Report No. 99-006, "Consolidation Process for FY 1997 Financial Statements for Other Defense Organizations," October 6, 1998. The report states that the DFAS Indianapolis Center has made progress in identifying, receiving, and consolidating financial information for Other Defense Organizations. However, additional improvements were needed by DFAS and accounting offices reporting financial information. DFAS Indianapolis Center did not establish timely reporting dates for supporting accounting offices that submit trial balances for consolidation into the financial statements for Other Defense Organizations. Offices responsible for reporting information did not comply with a DFAS requirement to submit monthly trial balances, and DFAS Indianapolis Center had not developed a process for using the monthly trial balances. As a result, the DFAS Indianapolis Center was unable to provide preliminary trial balances in a timely manner to support the required audits of the annual financial statements of Other Defense Organizations. Also, the DFAS Indianapolis Center was unable to review and reconcile information from trial balances with financial data from other sources. Until the weaknesses are corrected, financial data included in the financial statements for Other Defense Organizations will not be complete, comprehensive, and readily auditable.

The report recommended that the Director, DFAS Indianapolis Center, require supporting accounting office to submit financial information in sufficient time to meet deadlines agreed to by DFAS and the IG, DoD, and to establish procedures and reallocate resources as necessary to fully implement an interim process for quarterly general ledger trial balance reporting. The report further recommended that the Directors, DFAS Centers at Cleveland, Columbus, Denver, and Indianapolis, and Directors, National Security Agency and Defense Intelligence Agency, provide quarterly trial balances to the DFAS Indianapolis Center. DFAS had not responded to the report.

Report No. 98-178, "Internal Controls and Compliance With Laws and Regulations for the FY 1997 Financial Statements of Other Defense Organizations," July 13, 1998. This report states that DFAS Indianapolis Center internal controls did not ensure effective accounting, compilation, and presentation of the financial statements of Other Defense Organizations. The lack of transaction-driven general ledger accounting systems for Other Defense Organizations, and the lack of audit trails and reconciliation procedures contributed to the ineffective internal controls. As a result, the financial statements were not auditible or reliable. The report further stated that the Defense Finance and Accounting Service Indianapolis Center and the accounting offices that support Other Defense Organizations did not fully comply with the CFO Act, the Federal Manager's Financial Integrity Act, and the DoD Financial Management Regulation. Until significant improvements in the accounting

systems and internal controls are made, financial statements for Other Defense Organizations will not be reliable and will not be in compliance with applicable laws and regulations. No recommendations were made because the needed corrective actions were cited in prior audit reports.

Report No. 98-062, "Compilation of the FY 1996 Financial Statements for Other Defense Organizations," February 4, 1998. This report states that the compilation process used by DFAS Indianapolis Center needed improvements to ensure that the financial statements were complete, consistent, accurate, and fully supported. Specifically, the DFAS Indianapolis Center:

- made unsupported year-end adjustments, totaling \$88.3 billion to the FY 1996 trial balances submitted by the supporting accounting offices;
- understated the financial statements by \$207 million in assets, \$1.4 billion in liabilities, \$308 million in net position, and \$2.2 billion in expenses by omitting information from certain appropriations;
- prepared inaccurate and incomplete Notes to the financial statements, and did not prepare all the required Notes.

As a result, the FY 1996 Financial Statements of Other Defense Organizations were not reliable and did not accurately or completely present the financial condition and results of operations. The report recommended that DFAS include all required Notes to the financial statements, disclose deficiencies in accounting systems that could affect the reliability of balances, and fully explain summary adjustments made to trial balances submitted by supporting accounting offices. DFAS concurred with the recommendations and stated that corrective actions were completed.

Report No. 98-027, "Comprehensiveness of the FY 1996 Other Defense Organizations Financial Statements," November 28, 1997. This report states that the FY 1996 financial data, prepared by the DFAS Indianapolis Center for the Other Defense Organizations financial statements, were not comprehensive. The DFAS Indianapolis Center excluded from the FY 1996 financial statements.

- part or all 11 appropriations accounts that were reopened by the Department of the Treasury;
- certain canceled and merged appropriation accounts that could not be closed because of negative balances, and
- portions of 14 open appropriation accounts

As a result, the amounts shown for six lines in the Statement of Financial Position were inaccurate. The report recommended that the Director, DFAS Indianapolis Center:

- report the total operations of Other Defense Organizations as reflected in the fiscal year-end "Report(s) on Budget Execution;"

- modify the automated systems to include the total operations of Other Defense Organizations, and adjust the beginning balance of accounts to be included in the FY 1997 Statement of Financial Position; and
- review the staffing requirements needed to successfully compile the financial statements for Other Defense Organizations.

DFAS generally concurred with the recommendations and corrected computer-programming errors by December 1997 and completed a staffing review in September 1997.

Report No. 97-155, "Internal Controls and Compliance with Laws and Regulations for the FY 1996 Financial Statements of the 'Other Defense Organizations' Receiving Department 97 Appropriations," June 11, 1997. This report states that the financial statements for Other Defense Organizations were not accurate and reliable. Unless improvements in accounting systems and internal controls are made, the future financial statements for Other Defense Organizations will not be reliable. The DFAS Indianapolis Center and the accounting offices supporting Other Defense Organizations were unable to fully comply with applicable laws and regulations. As a result, the financial statements of Other Defense Organizations were not in full compliance with the CFO Act and the Federal Manager's Financial Integrity Act.

The report recommended that the Director, DFAS Indianapolis Center, maintain records for audit trails of all adjustment transactions; reconcile the current-year Department 97 expenditure data for the Fund Balance With Treasury account to the Department of the Treasury data; and document the review process used and decisions made regarding the auditors' recommended adjustments to the Principal Statements, including the footnotes. The DFAS Indianapolis Center stated that the Defense Joint Accounting System, scheduled to be fully implemented by June 2001, will capture data at the detailed transaction level. However, the DFAS Indianapolis Center partially concurred with the recommendation to maintain audit trails, suggesting that it also be directed to the organizations included in Other Defense Organizations. The DFAS was implementing procedures, scheduled to be fully implemented by December 1998, to perform reconciliations with Fund Balance With Treasury. The DFAS Indianapolis Center concurred with the recommendations and agreed to work closely in the future with the IG, DoD, to coordinate adjustments and footnote disclosures.

Appendix C. Report Distribution

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Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Logistics Agency
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency

Non-Defense Federal Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on National Security, Committee on Appropriations

House Committee on Government Reform and Oversight

House Subcommittee on Government Management, Information, and Technology,

Committee on Government Reform and Oversight

House Subcommittee on National Security, International Affairs, and Criminal Justice,

Committee on Government Reform and Oversight

House Committee on National Security

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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